UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

No. 22487

ROBERT W. NEES,

Petitioner,

v.

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

On Petition For Review of an Order of the
Securities and Exchange Commission

ANSWERING BRIEF OF THE SECURITIES AND EXCHANGE COMMISSION, RESPONDENT

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COUNTERSTATEMENT OF THE ISSUE

May a respondent who had been notified of charges made against him in an administrative proceeding require that a hearing involving numerous parties be repeated because a notice of that hearing, although mailed to a proper address, was not received by him, when he has subsequently been afforded a full and fair opportunity to cross-examine all material adverse witnesses, to make specific objection to consideration of documentary evidence and otherwise to defend against the charges?

COUNTERSTATEMENT OF THE CASE

Robert W. Nees ("Nees") has petitioned this Court, pursuant to Section 25(a) of the Securities Exchange Act of 1934 ("Exchange Act"), 15 U.S.C. 78y(a), to review two orders of the Securities and Exchange Commission by which he has been barred from further association with any

broker or dealer in securities.[1] The orders were entered at the conclusion of administrative proceedings conducted by the Commission pursuant to Sections 15(b) and 15A of the Exchange Act, 15 U.S.C. 78o(b), 78o-3 (R. 1228-1232). The respondents were Century Securities Company ("Century"), which had been registered with the Commission as a broker and dealer in securities, that firm's two general partners and six individuals, including Nees, who had been its sales representatives.[2] The proceedings were held to determine whether the respondents had, among other things, willfully violated antifraud provisions of the Securities Act of 1933 ("Securities Act") and of the Exchange Act[3] in the offer and sale of securities issued by Jayark Films Corporation ("Jayark").

1/ The Commission's order, dated July 14, 1967 (R. 2012), was based upon its findings and opinion of the same date (R. 2000-2011). A Memorandum Opinion and Order Denying Rehearing, Leave to Adduce Additional Evidence, and Stay was subsequently entered on November 1, 1967 (R. 2013-2017).

The record before the Commission is cited in this brief as "R. ____." Nees's opening brief in this Court is cited as "Br. ___."

2/ In addition to the action taken against Nees, the order (R. 2012) revoked the registration of Century as a broker and dealer and barred three other salesmen as well as Century's two owners from further association with any broker or dealer. The Commission had previously taken action against one salesman whose offer of settlement had been accepted (R. 1996-1997) and against another who had defaulted (R. 1998-1999).

William Reigel, one of the salesmen who has been barred by the Commission's final order, has also petitioned this Court for review. His petition has been docketed as No. 22459. None of the other respondents before the Commission has sought review.

3/ Section 17(a) of the Securities Act of 1933, 15 U.S.C. 77q(a), and Sections 10(b) and 15(c)(1) of the Exchange Act, 15 U.S.C. 78j(b) and 78o(c)(1), as well as Rules 10b-5 and 15c1-2, 17 CFR 240.10b-5 and 240.15c1-2, promulgated by the Commission under the latter statute.

A copy of the order for proceedings was mailed to Nees in October 1964 (R. 1228-1232, 1237). There is no dispute that Nees received that order, or that the address in California to which it was directed was his mailing address. That order gave notice of the charges and stated that hearings would be held at a "time and place to be fixed" (R. 1231). As stated in Nees's brief (p. 3), he thereafter "moved outside the State." So far as the record shows, for at least ten months after his answer was filed on November 6, 1964 (R. 1250), he made no effort whatever to advise the Commission of his new address or to inquire about the status of the proceeding.

Meanwhile, a notice of hearings to be held in Los Angeles, California (R. 1274), was mailed to all parties, including Nees (R. 639-640), on July 7, 1965. Pursuant to this notice four days of hearings were held in Los Angeles in August 1965 at which six other respondents were present (R. 1a-544). At the hearing testimony was taken from 22 persons, and 57 exhibits were received in evidence (R. 639-1175).

After Nees failed to appear at the hearings held in August 1965, a request to enter default against him was filed on August 30 and again mailed to him at his address in California (R. 1291). Nees received this request and two months later, appearing by counsel, filed objections to entry of default (R. 1360, 1370-1371). He claimed that he had not received actual notice of the August hearing and requested "that the Hearing Officer reopen hearings . . . so that Respondent Nees might

respond to evidence allegedly against him" and "present his defense to the statement of charges" (R. 1360, 1371).

The hearing examiner agreed with the staff that in serving the notice of hearing "the Commission had a proper mailing address for Nees" (R. 1383). Nevertheless, as a matter of law he construed Rule 6(e) of the Commission's Rules of Practice, 17 CFR 201.6(e), to require actual receipt of the notice (absent a showing of an attempt to evade service) and concluded (R. 1384) that there had been "a failure of proof that Nees 'has been duly notified' of the hearing within the meaning of Rule 6(e)."[4/] Thus, on December 3, 1965, he ordered the hearings reopened, as Nees had explicitly requested, "to afford respondent Nees an opportunity to interpose a defense to the allegations of the order for proceeding and to respond to such evidence as has been or may be introduced against him . . ." (R. 1384-1385). The Commission subsequently held that Nees had been duly

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4/ At a conference prior to the August hearing, counsel for the Commission's Division of Trading and Markets had stated that he had learned "that Mr. Nees had entirely left the area, . . . and was residing somewhere in Minnesota . . . or Wisconsin" and that he had unsuccessfully endeavored to reach him by telephone. He also stated that he had been advised by one of the other respondents that the latter had "been unable to contact Mr. Nees." (R. 1o-1p.) The notice, sent to Nees's last known address by certified mail was not returned to the Commission as undelivered (R. 639, 640), but, as noted by the hearing examiner, "the Commission did not receive a return receipt indicating delivery of that order" (R. 1384). Inquiry revealed that the post office in California in fact forwarded the notice to an address in Minneapolis, Minnesota, which was apparently Nees's new address (R. 1348 n.3). The post office in Minneapolis, however, did not have any record whether the notice had actually been delivered (R. 1384 n.3).

served with the original notice of hearing, but that "the examiner had properly exercised his discretion in reopening the hearings" (R. 2010).

When the hearings were reopened on February 15, 1966 (R. 544a-638), the two witnesses who had testified to Nees's representations at the original hearings (R. 209-237; 344-362) reaffirmed their prior statements (R. 561-562; 593) and were cross-examined by his attorney (R. 562-569; 578-582; 594-596).[5/] In addition, Nees testified in his own defense (R. 596-632). He did not, however, seek to cross-examine Fred Colton, one of the other

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5/ One customer testified that, among other things, Nees told him in July 1963 that it was just a matter of days before Jayark would sign a $50 million film contract that might profit Jayark by as much as $10 million (R. 214-215, 563, 573-574). Nees represented that Jayark was making money (R. 216) and had sent the customer a circular purportedly to verify what he had said (R. 218-219, 563-564). But it contained no financial information (R. 1174-1175). Indeed, no financial information about Jayark was provided before a sale was made (R. 216-221, 563-565). When the investor advised Nees that he was not interested in speculations, he was advised that Jayark was not a speculation since the multi-million dollar film-agreement was virtually completed and it was going to make money (R. 578, 582, 586). The same witness was told that the shares offered at 7-1/2 would be worth $10 or $12 within six months and could go to $30 if held for a longer period (R. 214-215). Nees also led another customer to believe that Jayark was sure to enter a contract for old movies to be shown on television and that the price of its stock would consequently double within a year (R. 349-350).

respondents, who had testified adversely to Nees at the August hearings (R. 444-445), although Colton was present at the reopened hearings (R. 545).[6/]

Counsel for Nees was not satisfied, however, with being provided the full opportunity that had been requested to answer the evidence and present Nees' defense; he still objected generally "to all the evidence, both oral and in exhibit form, that the Hearing Examiner . . . ruled as being part of the record . . . against Respondent Nees" from the earlier hearings (R. 560, 633) and objected as well to the supposed binding effect of stipulations to which Nees had not been a party. Although Nees' counsel was acquainted with the record (R. 557) and had been offered an opportunity by the hearing examiner to object specifically to particular evidence (R. 558), he rested on his blanket objection. The hearing examiner overruled the general objections and permitted the record of the original

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6/ Colton testified that he had "distributed to the . . . [salesmen] the reports on Jayark that are in evidence," and had "divulged [to] all of my salesmen the financial condition of Jayark" (R. 446). He "told the salesmen that Jayark was operating at a deficit, that clients should be notified when purchasing their stock" (R. 445-446).

Colton's testimony shows also that Nees and the others at Century knew very little about the negotiations for the film contract that Nees had described to the investors in glowing terms. The respondents knew that negotiations were in progress, but they "had no knowledge of the actual ending of negotiations," or that any "deal was closed" (R. 445). Respondents' Exhibit E (R. 1174-1175), which was accepted "as an indication of the nature of the advice received" by Century from the president of Jayark (R. 427), was introduced in evidence by Colton. Aside from assertions of optimism, that letter, consistent with Colton's testimony, revealed little more then the existence of the negotiations and cautioned that "there is no way of knowing, of course, whether these negotiations will succeed . . ." (R. 1174).

hearings to stand against Nees in view of the ample opportunity afforded him to make appropriate objections, to cross-examine the witnesses who had testified and to introduce evidence of his own (see R. 547-561; 633).

Based upon the record as a whole, the hearing examiner filed an initial decision on August 31, 1966, in which he found, among other things, that in the sale of Jayark stock, Century, its owners and salesmen, including Nees, had willfully violated the antifraud provisions of the Securities Act and the Exchange Act. Relying primarily upon the testimony of the two witnesses that Nees's attorney had cross-examined, the examiner found that Nees had made "glaringly false and unwarranted representations" in the sale of securities (R. 1699), and that certain of his activities "constituted a reckless abandonment and disregard of his obligation for fair dealing in accordance with the standards of the profession" (R. 1700).

Upon an independent review of the entire record (R. 2001), the Commission concluded

> "that respondents [including Nees] engaged in a scheme to defraud investors by means of a persistent high-pressure campaign over the telephone to sell the speculative stock of Jayark, which involved the use of fraudulent representations and predictions" (R. 2001),

which were made "without a reasonable basis." (R. 2003). It also found that all the respondents had failed to tell their customers about Jayark's adverse financial condition prior to their purchases (R. 2003). Thus, the Commission found Nees to have willfully violated or aided and abetted violations of the antifraud provisions, as charged (R. 2001-2006). It barred him from further association with any broker or dealer (R. 2112).

ARGUMENT

NEES WAS AFFORDED A FAIR HEARING

Nees does not contend that the Commission's findings that he engaged in fraudulent conduct of a serious nature are without a substantial basis on the entire record. Nor does he argue that the sanction imposed upon him was inappropriate on this basis. His sole complaint is a procedural one. In this connection it should also be made clear that there is no surviving issue before this Court as to the service of the notice of the August hearings. Because the hearing examiner reopened the proceedings on Nees's motion, despite the fact that the motion was made more than two months after Nees had admittedly learned that the hearing had been held (R. 1370), whether due notification of the August hearing had originally been given to Nees is at most of academic interest. 7/ Section 10(e) of the Administrative Procedure Act, as codified, 5 U.S.C. 706, provides that "due

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7/ In any event the Commission was clearly correct that "Nees was duly notified of the hearings" (R. 2010). Pursuant to Rule 6(b) of the Commission's Rules of Practice, 17 CFR 201.6(b), the notice of hearing mailed to Nees was "addressed to his last known business or residence address. . . ." (p. 3, supra). It is well settled that a proper mailing will satisfy due process requirements. See, e.g., Travelers Health Ass'n v. State Corporation Commission, 339 U.S. 643, 650-651 (1950); Mullane v. Central Hanover Bank & Trust Co., 339 U.S. 300, 318-319 (1950); International Shoe Co. v. Washington, 326 U.S. 310, 320 321 (1945). Nevertheless, the hearing examiner held that Nees had not been "duly notified" within the meaning of Section (e) of the same rule. Without disagreeing with any of the hearing examiner's factual findings, the Commission read Rule 6(e) differently. In the absence of any contrary authority, the Commission was surely not foreclosed by the hearing examiner's purely legal conclusion from making its own reasonable construction of the rule it had adopted.

account shall be taken of the rule of prejudicial error" by a court reviewing agency action.

A. The Procedure Adopted Met the Requirements of Due Process.

The entire relief sought by Nees in his "OBJECTIONS TO ENTRY OF DEFAULT AND REQUEST TO REOPEN HEARING" was as follows:

> "Respondent ROBERT W. NEES hereby requests that the Hearing Officer reopen hearings in the above matter so that respondent NEES may respond to evidence allegedly against him." (R. 1360.)

This is precisely the relief that the hearing officer provided (see p. 4, supra). Nees apparently contends (Br. 21-23), however, that this relief does not afford "fundamental rights of due process." But that constitutional guaranty does not mandate any particular form of procedure; nor does it determine when, in the course of an administrative proceeding, a hearing should or must be held. These are matters left to the discretion of the agency in the exercise of its housekeeping powers. See Inland Empire District Council v. Millis, 325 U.S. 697, 710 (1945); Opp Cotton Mills, Inc. v. Administrator, 312 U.S. 126, 152-153 (1941).

Of course, the right to a hearing involves a fair opportunity to confront and cross-examine material adverse witnesses, to respond to the evidence adduced or make proper objection to its consideration and otherwise to defend against charges made. That opportunity may be afforded, however, at any time before a final order becomes effective. See, e.g., Ewing v. Mytinger & Casselberry, Inc., 339 U.S. 594, 598-600 (1949); Lichter v. United States, 334 U.S. 742, 791-792 (1948); Opp Cotton Mills, Inc. v. Administrator, supra, 312 U.S. at 152-153. This is particularly

so when prior hearings have already been held, and it would greatly inconvenience not only the Commission's staff but also the other respondents, numerous witnesses and the hearing examiner to start all over again. 8/

Nees cites no authority that holds that a subsequent opportunity to cross-examine witnesses or otherwise make a defense is not sufficient. 9/ The recent case of Hansen v. Securities and Exchange Commission, 396 F. 2d 694 (C.A. D.C.) (per curiam), certiorari denied, 393 U.S. 847 (1968), is

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8/ Nees's reliance (Br. 14-17) on Rule 15 of the Commission's Rules of Practice, 17 CFR 201.15, dealing with the taking of depositions is misplaced. There appears to be nothing in Rule 15 that would prevent a hearing examiner, in connection with depositions, from permitting a procedure analogous to that adopted here. If, for example, an additional party were named in a proceeding after a deposition had been taken, we think that under Rule 15, consistent with due process, the examiner could simply permit him to cross-examine the deponent on the basis of his earlier testimony. In any event, the entire argument begs the question before this Court. It does not seem that the provisions of Rule 15 vary materially from usual provisions pertaining to notice and opportunity to participate that apply to hearings. Indeed, paragraph (b) of the rule provides that "[e]xamination and cross-examination of deponents may proceed as permitted at the hearing." Thus, Nees's unsupported conclusions with respect to Rule 15 are entitled to no greater weight than his similarly unsupported contentions about the procedure actually in issue.

9/ The only authority that even comes close to the actual issue involved in this case, Brown-Pacific-Maxon Co. v. Toner, 255 F. 2d 611 (C.A. 7, 1958), involved a situation in which the agency relied upon correspondence neither in the record nor mentioned in its decision and had never given the complaining party an opportunity to respond to it.

directly contrary to Nees's contention. There it was explicitly held that

> ". . . it was within the Commission's discretion to receive [in evidence] the transcribed testimony [from an earlier proceeding], while still comporting with fairness to petitioner by offering the opportunity to cross-examine any witness whose transcribed testimony was so received." 10/

B. Nees's Defense Was in No Way Prejudiced by the Procedure Used.

At the February hearing Nees's counsel cross-examined the two customer-witnesses who had previously testified against Nees (R. 562-569, 578-582, 594-596). Although he now states that the value of contemporaneous cross-examination "was never more vividly illustrated" (Br. 18), he does not point to a single specific example to support this claim. Indeed, with equal lack of specificity he emphasizes the effectiveness of his cross-examination (Br. 17-18).

10/ Cf. Giant Food, Inc. v. Federal Trade Commission, 322 F. 2d 977 (C.A. D.C., 1963), certiorari dismissed, 376 U.S. 967 (1964), a dictum from which is cited on p. 13 of Nees's brief. There the court actually held that, since a subsequent opportunity to cross-examine had been offered but had been refused, the contention that direct testimony, given on an earlier occasion "was not properly part of the record fails." 322 F. 2d at 984. See also Paramount Cap Mfg. Co. v. National Labor Relations Board, 260 F. 2d 109, 113 (C.A. 8, 1958); Railway Express Agency v. Civil Aeronautics Board, 243 F. 2d 422, 424 (C.A. D.C., 1957); In re McNary, 83 F. Supp. 121, 122 (N.D. N.Y., 1949). And cf. Freight Consolidators Cooperative, Inc. v. United States, 230 F. Supp. 692, 699 (S.D. N.Y., 1964):

> "Assuming arguendo that . . . [certain respondents in an administrative proceeding] were injured by the failure of the [Interstate Commerce] Commission to grant them a de novo hearing, then any harm ensuing could have been cured by them. They were afforded an opportunity to recall and cross-examine witnesses but declined to do so."

Nees also vaguely asserts that the Commission's findings against him are based upon "the testimony of other witnesses" in addition to that of these two customers (Br. 14). Since the customers themselves testified as to the representations and predictions made by Nees and his failure to provide them with any financial information about Jayark (see p. 5, n. 5, supra), Nees appears to refer to the testimony of Fred Colton, which proved that Nees was in possession of adverse financial information about Jayark and had no basis for the representations and predictions (see p. 6, n. 6, supra). With respect to Colton, Nees's contention is not only unjustified but actually misleading. As a respondent, Colton was present and available for cross-examination by Nees at the reopened hearings (R. 545). The fact that he was not cross-examined cannot be blamed upon the procedures adopted by the hearing examiner; it is a result, simply, of Nees's failure to recall him to the stand. Indeed, with respect to all of the prior witnesses, Nees's counsel had been offered the opportunity to indicate which of them they wished to have attend the February hearing but indicated that they would require only the presence of the two customer-witnesses (see R. 548, 1557-1563). Thus, Nees has no basis for complaint in this regard.

Before the hearings were reopened, Nees claimed the right to object to consideration of documents that had been admitted in evidence at the original hearings (R. 1548-1551); the record is clear that he was given the opportunity to do so. At the reopened hearings counsel for Nees objected generally "to all the evidence, both oral and in exhibit form,

that the Hearing Examiner . . . ruled as being part of the record . . . against Respondent Nees" from the earlier hearings (R. 560, 633). He declined the expressly offered opportunity, however, to make specific objections to particular evidence (R. 558), after having indicated that he would not object to introduction of the evidence in the record if that were done in his presence (R. 557).

The examiner properly overruled objections made in general form to the contents of the entire record. He was plainly not obliged himself to examine each item in it to ascertain which of them pertained to Nees and which of those were for any reason objectionable. Cf. Continental Oil Co. v. United States, 184 F. 2d 802, 814 (C.A. 9, 1950). Furthermore, even if Nees were now specific in his contentions before this Court, and some basis for objection could be found, it is a "cardinal principal . . . that a general objection, if overruled, cannot avail the objector on appeal . . . ." 1 J. Wigmore, Evidence § 18, at 332 (3d ed. 1940)(emphasis in original), and authorities cited there. See North Whittier Heights Citrus Ass'n v. National Labor Relations Board, 109 F. 2d 76, 83 (C.A. 9), certiorari denied, 310 U.S. 632 (1940); Cook-O'Brien Constr. Co. v. Crawford, 26 F. 2d 574, 575 (C.A. 9, 1928) (claimed failure to provide original documents); Curtis v. North American Indian, Inc., 277 Fed. 909, 911 (C.A. 9, 1922) (claim of improper authorization); cf. Hartzell v. United States, 72 F. 2d 569, 583-584 (C.A. 8, 1934) (no foundation laid).

In any event, the documentary evidence pertinent to Nees was unobjectionable. The language and legislative history of Section 7(c) of the Administrative Procedure Act, as codified, 5 U.S.C. 556(d), make clear that "the exclusionary rules of evidence do not apply" in administrative proceedings. S. Rep. No. 752, 79th Cong., 1st Sess. (1946), pp. 22-23. See Federal Trade Commission v. Cement Institute, 333 U.S. 683, 705-706 (1948); Consolidated Edison Co. v. National Labor Relations Board, 305 U.S. 197, 229-230 (1938); Willapoint Oysters, Inc. v. Ewing, 174 F. 2d 676, 690 (C.A. 9), certiorari denied, 338 U.S. 860 (1949). Furthermore, a showing of relevance and ample authentication of the exhibits material to Nees was provided by the witnesses who were present at the reopened hearings. Mr. Colton had "distributed to the men [including Nees] the reports on Jayark that are in evidence" (R. 445), and both Nees (R. 599, 602) and the investor to whom it had been mailed (R. 217, 563-564) testified concerning the only exhibit (R. 997-998) upon which the Commission explicitly relied in making its findings against Nees (R. 2002).

Finally, Nees claims that he has been held to stipulations to which he did not agree, particularly with respect to proof that he used the mails or instrumentalities of interstate commerce (Br. 18, 22). Except for a few immaterial agreements that may have been reached in the course of the hearings, however, the only stipulation of facts contained in the record was entered at the pretrial conference held August 5, 1965 (R. 1p-1s, 6-10). It is clear from the terms of the stipulation that the agreed facts and the related exhibits (R. 642-855) do not pertain to

the substance of the anti-fraud violations Nees has been found to have committed. They relate instead to the registration requirements under Section 5 of the Securities Act of 1933, 15 U.S.C. 77e, which other of the respondents, but not Nees, were found to have violated (R. 2007-2008). The hearing examiner explicitly ruled that this stipulation was not binding upon Nees since he was not present (R. 1n). Nees makes no showing that the Commission improperly relied upon it against him.

With respect to proof of Nees's use of the jurisdictional means the record is replete with evidence supporting the Commission's jurisdiction to take remedial action against Nees. When Nees voluntarily took the stand at the reopened hearings, he himself confirmed the investors' testimony that he had used the mails in connection with the sale to them of Jayark securities (e.g., R. 216-217, 221, 563-564, 599, 602); that he also used the telephone--an instrumentality of interstate commerce Myzel v. Fields, 386 F. 2d 718, 727-728 (C.A. 8, 1967), certiorari denied, 390 U.S. 951 (1968)--is likewise clear (e.g., R. 211, 349, 599, 603-604).

CONCLUSION

For the reasons stated, the order of the Commission barring Nees from association with any broker or dealer should be affirmed.

Respectfully submitted,

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